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IN THE

Supreme Court of the United States

OCTOBER TERM, 1954

ROSE J. LINDE, *Petitioner*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT.

Comes now Rose J. Linde, petitioner, by her attorneys, Stephen H. Hart and Claude M. Maer, Jr., and respectfully petitions this Court for writ of certiorari to review the judgment of the United States Court of Appeals for the Ninth Circuit in the case of Commissioner of Internal Revenue v. Rose J. Linde, Docket No. 13417; and respectfully represents:

OPINIONS BELOW

The opinion rendered by the Tax Court of the United States in this case is reported at 17 T.C. 584. A

copy of this opinion appears in the transcript of record at pages 118 through 130 and the findings of fact by the Tax Court appear on pages 106 through 118 of the transcript of record. The opinion of the United States Court of Appeals for the Ninth Circuit is reported at 213 F. 2d 1. A copy of this opinion is contained in Appendix A attached hereto.

GROUNDS FOR JURISDICTION

The grounds on which the jurisdiction of the Supreme Court of the United States is invoked are as follows:

a. The date of the judgment sought to be reviewed is May 4, 1954, and it was entered on that date.

b. The Order denying petition for rehearing is dated June 7, 1954.

c. It is believed that 28 U.S.C. 1952 ed., Sec. 1254, confers upon the Supreme Court of the United States jurisdiction to review the judgment in question by writ of certiorari.

QUESTIONS PRESENTED FOR REVIEW

1. Whether the proceeds received by the petitioner in ~~1954~~ in liquidation of the wine pools in which she held interests bequeathed to her by her husband constitute "income in respect of a decedent" taxable to her under Section 126 of the Internal Revenue Code of 1939, 26 U.S.C. 1946 ed., Sec. 126, as was held by the Court of Appeals; or whether the Tax Court correctly held that the payments did not constitute Section 126 income be-

cause they were attributible to sales made after the decedent's death.

2. Whether the amounts by which the proceeds from the liquidation of the wine pools received by the estate in 1944 and distributed to petitioner in that year (excluding the proceeds from the East-Side Winery's 1942 pool) exceeded the fair market value of petitioner's interest in the pools when she acquired them (the value of decedent's interest in the pools for Federal estate tax purposes) are taxable to her in the year 1944 as capital gains under Section 117 of the Internal Revenue Code of 1939, 26 U.S.C. 1946 ed., Sec. 117.

3. In the alternative, if this Court should decide that the proceeds from the liquidation of the wine pools constitute "income in respect of a decedent" under Section 126 of the Internal Revenue Code of 1939, 26 U.S. C. 1946 ed., Sec. 126, then the question arises as to whether the liquidation proceeds received by the estate in 1944 and distributed to petitioner in that year are taxable to petitioner at all. It was conceded by Respondent in the Court of Appeals that Section 126 income to an estate is not income which is subject to being currently distributed to a beneficiary under Section 162 of the Internal Revenue Code of 1939, 26 U.S.C. 1946 ed., Sec. 162.

4. Whether the amount by which the liquidation proceeds from the East-Side Winery's 1942 pool received by the estate in 1944 and distributed to petitioner in that year exceeded the fair market value of petitioner's interest in that pool when she acquired it (the value of decedent's interest in that pool for Federal estate tax

purposes) is taxable to her as ordinary income under Section 22 (a) of the Internal Revenue Code of 1939, 26 U.S.C. 1946 ed., Sec. 22 (a), as the Court of Appeals held, or not taxable to petitioner at all, as the Tax Court held, or taxable to petitioner as capital gain under Section 117 of the Internal Revenue Code of 1939, 26 U.S.C. 1946 ed., Sec. 117.

STATUTES AND REGULATIONS INVOLVED

Internal Revenue Code:

Section 22, 26 U.S.C. 1946 ed., Sec. 22.
Section 111, 26 U.S.C. 1946 ed., Sec. 111.
Section 113, 26 U.S.C. 1946 ed., Sec. 113.
Section 117, 26 U.S.C. 1946 ed., Sec. 117.
Section 126, 26 U.S.C. 1946 ed., Sec. 126.

Judicial Code, 28 U.S.C. 1952 ed., Sec. 1254.

California Agricultural Code, Sec. 1208 (Deering, 1950).

Treasury Regulations 111:

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Sec. 29.22(a) - 7
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Sec. 29.113(a)(5) - 1
Sec. 29.117 - 1
Sec. 29.126 - 1

These are set out in Appendix B to this petition attached hereto.

STATEMENT OF THE CASE

The facts found by the Tax Court (R. 106-118) may be summarized as follows:

The taxpayer, Rose J. Linde, formerly Mrs. Rose J. Lange, resides at Lodi, San Joaquin County, California. She duly filed her income tax returns for the years 1944 and 1945 with the Collector of Internal Revenue for the First District of California. (R. 106-107.)

Taxpayer was the sole beneficiary and executrix of the estate of her deceased husband, Herman C. Lange (sometimes hereinafter referred to as the decedent), who died December 10, 1943. (R. 107.)

The taxpayer filed an income tax return on behalf of the decedent for the period January 1 to December 10, 1943, on the cash receipts basis, the same method as was regularly employed by the decedent. As executrix of the decedent's estate, she filed a fiduciary income tax return for the period December 10, 1943, to November 30, 1944. Both such returns were filed with the Collector of Internal Revenue for the First District of California. The administration of the decedent's estate was terminated December 19, 1944, and in that month all the property of the estate was distributed to taxpayer as sole beneficiary under the decedent's last will and testament. (R. 107.)

Decedent during his lifetime was a farmer. He owned and operated vineyards located in the vicinity of Lodi, San Joaquin County, California. In order better to market wine grapes grown in his vineyards, he acquired membership interests in the East-Side Winery and the Cherokee Vineyard Association, cooperative marketing associations organized under the provisions of Chapter 4 of the Agricultural Code of the State of

California as nonprofit cooperative marketing associations. Their principal purpose was the processing of their members' grapes into wine and other grape products and the marketing of these products on behalf of its members. Decedent also held memberships in other marketing associations, including the Lodi Winery. (R. 107-108.)

Both the East-Side Winery (hereinafter sometimes called the East-Side) and the Cherokee Vineyard Association (hereinafter sometimes called the Cherokee) operated in a similar manner. In order to market his grapes through these associations, a grower was required to become a member and membership was limited to growers. The rights and duties of the members, as well as those of the associations, were defined in the articles of incorporation and the by-laws of each association, the marketing agreements between the members and the associations and, in the case of Cherokee Vineyard Association, a membership agreement. The relationship between the associations and their members in the actual marketing operations was governed largely by the terms of the marketing agreements.

The forms of the marketing agreements of each association read in part as follows (R. 108-112):

1. *East-Side Winery*:

> This [marketing] agreement between the East-Side Winery, hereinafter called the "Association" and the undersigned, hereinafter called the "Grower," Witnesseth:
>
> (1) That the Association shall buy and the

Grower shall sell to the Association each and every year after the date of this agreement, such number of tons of grapes as may be agreed upon from time to time between the Association and the Grower, it being understood and agreed that the Grower shall have the privilege of selling and delivering to the Association from time to time such proportion of all the grapes which the Association shall from time to time, decide to accept and receive, as the number of shares of stock held by the Grower shall bear to the total issued and outstanding stock.

* * * *

(3) The Association agrees to manufacture such grapes, together with the grapes delivered by other growers, into wine, brandy or such other products as the Association may determine and to sell such wine, brandy or other products and pay over ratably the net amount received therefrom as payment in full to the Grower after making such deductions to cover cost of manufacturing, advances, the cost of receiving, pooling, handling, grading, processing, financing, advertising, storing, insuring, selling, marketing and building assessments, debts and other charges, as determined by the Board of Directors from time to time; and for organization, operating and maintenance expenses, stock in a central agency and reserves, but such reserves shall not exceed five per cent of the gross sales price, which reserves may be used by the Association for any proper purpose.

* * * *

(6) The Grower further agrees that the Association shall have the power to borrow money for any purpose of the Association on the pools of wine, brandy or any other product held in storage by the Association; and shall exercise all other rights of ownership without limitation and may sell or pledge for its own account or as security for its own debts or otherwise all or any part of any such pools or warehouse receipts, account sales or other documents covering said pools of wine, brandies or other products or received on account thereof.

(7) It is agreed that the charter, the by-laws now or hereafter in effect and this contract constitute the entire agreement between the Association and the Grower.

• • • •

(10) The Association shall have the right to make pools of each kind of wine and of the wine made from each kind of grapes or to blend the same as in the opinion of the Board of Directors may seem best and settlements with the Grower shall be made at such time or times as the Board of Directors may elect and settlement shall be made upon the basis of the amount of moneys received from sale or sales of the product from each pool or pools respectively, rather than upon the basis of the tonnage of grapes delivered.

2. *Cherokee Vineyard Association*:

This [marketing] agreement between the Cherokee Vineyard Association, hereinafter called the

"Association" and the undersigned, hereinafter called the "Grower," Witnesseth:

Section 1. In the consideration of covenants herein contained, the Association buys and the Grower sells to the Association, annually from the date of the signing of the Membership Agreement of which this is a part, the number of tons of grapes stated in the Membership Agreement, divided between the varieties therein specified.

And the Grower agrees to deliver such grapes to the plant of the Association or to any such other place as the Association may direct, but if deliveries required to be made distances greater than to the plant the Association will pay the difference between the reasonable cost of delivery to the plant and the reasonable cost of delivery to the place designated.

Section 2. The Association agrees that on the delivery of grapes hereunder that it may make such advances to the Grower on such grapes as in the discretion of the Directors may be justified by marketing conditions.

Section 3. The Association agrees to receive, sell or process, manufacture and convert such grapes together with the grapes delivered by other growers into wine, brandy or such other products as the Association may determine and to sell such wine, brandy or other products and pay ratably the net amount received therefrom as payment in full to the Grower after making deductions to cover cost

of manufacturing, advances, interest upon advances, the cost of receiving, pooling, handling, grading, processing, financing, advertising, storing, insuring, selling, marketing and building assessments, as determined by the Board of Directors; and for organization, operating and maintenance expenses, stock in a central agency, Revolving Fund retains and reserves, but such reserves shall not exceed five (5) per cent of the gross sales price, which reserves may be used by the Association for any proper purpose.

• • • •

Section 6. The Grower further agrees that the Association shall have the power to borrow money for any purpose of the Association on the pools of wine, brandy, or any other product held in storage by the Association; and shall exercise all other rights of ownership without limitation and may sell or pledge for its own account or as security for its own debts or otherwise all or any part of any such pools or warehouse receipts, account sales or other documents covering said pools of wine, brandies or other products or receivables on account thereof.

• • • •

Section 8. It is agreed that the Articles of Incorporation, the By-Laws now or hereafter in effect and this agreement, constitute the entire agreement between the Association and the Grower.

Pursuant to such agreements, members delivered to the associations' wineries a certain quantity of grapes. The grapes were then commingled with those of other

members and became part of what was termed a "wine pool" of that particular year. Each member was assigned a percentage of interest in the pool in proportion to the quantity of grapes he had delivered after certain adjustments were made for the variety of his grapes and, in some instances, sugar content. The associations crushed the grapes, processed them into wine, brandy and other grape products and then marketed these products. In their processing and marketing operations, the associations incurred various processing, selling and administrative expenses. They sometimes borrowed money to meet these current expenses. Ultimately, however, all their expenses and loans were paid out of the returns from the sales of products and the net proceeds were currently returned to the members of the pools in proportion to their previously determined percentages of interest therein. (R. 112-113.)

The procedure whereby the wine products were sold, the expenses set off against the sales proceeds, and the amounts payable to the members computed and distributed to them, is called "liquidation" of the pools. The period of time which elapsed between the delivery of the grapes to the wineries and the complete liquidation of the pools varied, depending upon the type of wine product which was being processed and the time consumed in marketing the wine products. (R. 113.)

Because of the peculiar nature of East-Side's 1938 pool, its liquidation consumed a period of years; however, in keeping with its normal procedure, East-Side completely liquidated its 1942 and 1943 pools within a period of about 18 months after the grapes were de-

livered to its winery. Cherokee aged some of its wine products and also marketed them through a central association, so that a period of six to seven years elapsed before its pools were completely liquidated. The associations did not wait until all of the products of the wine pools were sold to make payments to members, however, and as sales were made, expenses set off against these sales, and the net proceeds computed, such net proceeds were currently distributed to the members. (R. 113-114.)

For the vintage years 1937 to 1943, decedent was a party to marketing agreements with the Cherokee Vineyard Association and the East-Side Winery, and on his death held interests in several of their pools. When liquidation proceeds became payable, the associations paid the decedent's share of the proceeds to his estate in 1944 and to the taxpayer in 1945. (R. 114.)

There is set out on page 115 of the record a summary of the wine pools in which the decedent held an interest, the payments made, and any excess proceeds received over and above the appraised value for federal estate tax purposes.

An audit was made of the operations of East-Side during the calendar year 1943, when the 1942 pool was processed and marketed. The audit contained an analysis of 1942 pool liquidation payments received by members during 1943. This analysis shows that as of December 1943, the month in which decedent died, substantially all the wine in the 1942 pool had been sold. A value was assigned to the small quantity of unsold wine, added to the sales price of the wine sold, and from this total the var-

ious expenses were deducted, the remainder representing the total liquidation proceeds payable to the members. The unpaid balance of decedent's percentage of interest on December 31, 1943, was computed to be $14,047.19, the amount paid to the decedent's estate in 1944. East-Side's 1942 pool was completely liquidated during 1943 with the exception of actual distribution of some of the net proceeds due and owing members. (R. 116.)

In the year 1944, Cherokee paid to the decedent's estate the amount of $126.13, a return of capital which decedent had invested in its revolving fund. (R. 116.)

In the fiduciary income tax return for the year 1944 filed on behalf of decedent's estate, the amounts by which the proceeds received in liquidation of the wine pools exceeded their appraised value for federal estate tax purposes were reported as capital gains. The estate included what it computed to be the taxable portion of these gains in the taxpayer's distributive income. (R. 117.)

On her income tax return for the year 1945, taxpayer reported as long-term capital gains the amount which she computed to be the excess of certain of the wine pool payments received by her over and above the value of her interests in these pools when she acquired them. (R. 117.)

In determining the income tax liability of the taxpayer for the year 1944, the Commissioner computed the amount of taxpayer's fiduciary income to be $47,945.81, an increase of $46,495.51 over that reported by her. That increase was mainly due to the Commissioner's determination that amounts received from wineries totalling

$62,325.66 constituted items of gross income in respect of a decedent currently distributed to taxpayer and taxable to her under Section 126 of the Code. (R. 30-31, 117-118.)

All of the adjustments made by the Commissioner in computing the tax liability of the taxpayer for the year 1945 are the result of his determination that the total wine pool payments received by her in 1945 in the amount of $38,484.12 constitute items of gross income in respect of a decedent taxable to the taxpayer under Section 126 of the Internal Revenue Code. (R. 118.)

The Tax Court held (1) that the taxpayer is not taxable on any amounts of Section 126 income which may have been received by the decedent's estate and distributed to taxpayer in 1944 (R. 122); (2) the proceeds received by taxpayer in 1945 from the 1945 liquidation of the wine pools did not constitute items of gross income in respect of a decedent taxable to her in 1945 under Section 126 of the Code, with one exception (R. 126); (3) taxpayer is accountable for certain of the wine payments received in 1944 and 1945 in excess of estate tax valuations but such amounts are taxable to her as capital gains under Section 117 and not as ordinary income under Section 22 (a) of the Internal Revenue Code. (R. 126-130.)

The Court of Appeals held (1) that the Tax Court's findings as to the character of the 1944 receipts were not clearly erroneous and sustained its determination that these were capital gains; (2) the amount by which the liquidation proceeds from the East-Side Winery's 1942 pool received by the estate in 1944 and distributed to

petitioner in that year exceeded the fair market value of petitioner's interest in that pool when she acquired it (the value of decedent's interest in that pool for Federal estate tax purposes) was taxable to her as ordinary income; and (3) the proceeds from the liquidation of the wine pools received by petitioner in 1945 were income in respect of a decedent under Section 126 I.R.C. and taxable as ordinary income to petitioner.

BASIS FOR FEDERAL JURISDICTION

The jurisdiction of the Tax Court of the United States was invoked by petitioner pursuant to Section 272 of the Internal Revenue Code of 1939, 26 U.S.C. 1946 ed., Sec. 272.

REASONS AND ARGUMENT FOR ALLOWING THE WRIT

I

THE DECISION OF THE COURT OF APPEALS DIRECTLY CONFLICTS IN PRINCIPLE WITH A DECISION OF THE COURT OF APPEALS FOR THE FIFTH CIRCUIT.

Is income realized by a farmer or rancher solely from the act of growing crops or raising cattle without more? Is not a sale or exchange an indispensable element in the realization of income? Directly opposed answers to these questions have been reached recently by the Courts of Appeal for the Ninth and Fifth Circuits.

In *Campbell v. Prothro*, 209 F. 2d 331 (5th Cir. 1954), taxpayer Prothro, on the cash basis, gave his local

Y.M.C.A. 100 head of raised calves which had a zero income tax basis in his hands. Later the same year the calves were sold and the question was whether or not Prothro realized taxable income at the time of the gift. The Fifth Circuit held that a bona fide gift had been made and that Prothro realized no taxable income therefrom.

The similarity of the issues in Prothro's and petitioner's cases is readily apparent. No sale, no taxable event, occurred prior to the gift by Prothro or the death of Lange. The Fifth Circuit held that a sale or other taxable event was the prerequisite to the realization of income, but in direct opposition, the Ninth Circuit expressly rejected such a test. In determining the meaning of "*income* in respect of a decedent", the Court below held in effect that a taxable event is unnecessary to constitute the realization of such income (213 F. 2d 3):

> "While the Commissioner does undertake to argue that under the marketing agreements here involved there was a sale of grapes to the associations, we find it unnecessary at this stage to reach that question; for it is our judgment that even assuming that sales were not made by decedent during his lifetime, yet the amounts paid to the respondent taxpayer in 1945 pursuant to and in accordance with the agreements with the associations constitute 'income in respect of a decedent' within the meaning of section 126. We cannot agree with the Tax Court's conclusion that if such sales did not take place during the decedent's lifetime, section 126 has no application to the proceeds thus received by the taxpayer."

Against the requirement of a sale or exchange, the Government in the *Prothro* case advanced the argument based on the rule in *Helvering v. Horst,* 311 U.S. 112 (1940), that the calves, subject of the gift, "represented ordinary income in toto"; i.e., that since the interest coupons which were the subject of the gift in the *Horst* case represented ordinary income per se, the calves should be similarly treated. An excerpt from the taxpayer's brief in answer to this argument is quoted in the opinion at 209 F. 2d 334, 335:

> "The fundamental defect in the Government's position in the case at bar is that the animals here in question did not per se represent 'income'.
>
> ". . . Gains from the sale or exchange of property . . . do not arise, and therefore do not constitute 'gross income' until a sale or exchange for value has been consummated, regardless of taxpayer's method of accounting.
>
> ". . . raised livestock does not constitute income per se. This is because raised livestock are not claims or demands representing income fully earned but are instead chattels created by the livestock raiser through the instrumentality of his breeding herd and having an independent basis for gain or loss in his hands . . . *Gains from raised animals can only be realized if and when they are sold or disposed of by their owner for value in a taxable transaction.*" (Emphasis supplied)

The court agreed with this argument and highlighted

the distinction in these cases when it said, at 209 F. 2d 335:

> "Here the facts are entirely different from those of any of the cited cases. Here not interest due on choses in action in the year in which the assignment is made, but calves, chattels, *whose value could be realized only by a sale,* were given . . ." (Emphasis supplied).

The meaning of the term "income" was the question in both the *Linde* and the *Prothro* case. It has not been contended that the meaning of the word "income" as used in Section 22(a) is different from the meaning of the same word as used in Section 126. Yet the Fifth and Ninth Circuits reach diametrically opposite results when applying the same term to farm produce. This is a conflict in decisions and in principle which, it is respectfully urged, should be resolved by this Court.

II

THE DECISION OF THE COURT OF APPEALS CONFLICTS IN PRINCIPLE WITH APPLICABLE DECISIONS OF THIS COURT.

Realization of income as a prerequisite to taxation is the keystone of our tax laws and has been jealously guarded by this Court against repeated attack.

> *Eisner v. Macomber,* 252 U.S. 189 (1920), the stock dividend case.
>
> *Lucas v. North Texas Lumber Co.,* 281 U.S. 11 (1930), no income realized until sale of timber completed.

United States v. Safety Car Heating & Lighting Co., 297 U.S. 88 (1936), "Income is . . . . . not the potency of fruition. . . . ."

Putnam's Estate v. Commissioner, 324 U.S. 393 (1945), dividends declared prior to death of stockholder.

In holding in the instant case that the proceeds from the sale of the grapes and resulting wine pools were "income" in respect of a decedent, the Court of Appeals not only disregarded the test of realization established by the above-cited cases, but also overruled applicable regulations the substance of which have been in effect since the beginning of the income tax. U. S. Treas. Reg. 111, Sec. 29.22(a)-7. "Income" is realized by a cash basis farmer only upon sale or exchange of his farm produce.

The definition of the term "income" by this Court in *Helvering v. Enright's Estate,* 312 U.S. 636, 644 (1941), in specifically limited to "assets of decedents, *earned during their life* . . . . ." (Emphasis supplied). A vital element in the term "earned"—a sale or exchange—did not occur prior to Lange's death. It is respectfully suggested that the wine proceeds here at issue would not have been income in decendent's last return under the provisions of Section 42 of the Revenue Act of 1934 as construed by the *Enright* case and should not be considered "income" under the provisions of Section 126.

III

THE COURT OF APPEALS HAS ERRONEOUSLY DECIDED AN IMPORTANT QUESTION OF FEDERAL LAW WHICH HAS NOT BEEN, BUT SHOULD BE SETTLED BY THIS COURT.

The grape crops grown by decedent Lange during life had a zero basis for income tax purposes, but the unsold crops and his share in the resulting wine pools were appraised for substantial amounts at his death for estate tax purposes. Had decedent lived, this difference between basis and actual value would not become taxable income until the products were sold or exchanged. U. S. Treas. Reg. 111, Sec. 29.22(a)-7. Does his death make any difference? The Tax Court found that no sale, exchange or other taxable event occurred before Lange's death. Yet the Court of Appeals held that the occurrence of a taxable event prior to death was unnecessary to the application of Section 126—that petitioner was not entitled to the basis prescribed by Section 113(a)(5) or the immunity of Section 22(b)(3) —that the proceeds from the ultimate sales of the wine pools were taxable income to petitioner even though the sales occurred subsequent to Lange's death.

If this is correct law, would not appreciation in value of any and all assets owned by a decedent unrealized at death be taxed to decedent's successor under Section 126—stocks, bonds, real estate—all forms of property? Why discriminate against a farmer with respect to his crops?

This radical extension of the scope of Section 126,

I.R.C., by the Court of Appeals below, if carried to its logical conclusion, can only result in complete nullification of Sections 22(b)(3) and 113(a)(5), I.R.C. Implicit in these latter sections is the proposition, confirmed by years of acquiescence by the Commissioner, that appreciation in value of assets unrealized at death is not subject to income tax. *Estate of Tom L. Burnett,* 2 T.C. 897 (1943), appeal dismissed, on motion of Commissioner, 33 A.F.T.R. 1614 (5th Cir. 1944), decision acquiesced in by Commissioner, 1944 Cum. Bull. 4. In that case the Tax Court held that raised livestock and feed owned by a rancher at his death did not constitute income accrued to him within the meaning of Section 42 of the Revenue Act of 1938, predecessor of Section 126 of the 1939 Code. The confusion and uncertainty in the administration of the tax laws resulting from a broad application of this decision will inevitably give rise to protracted litigation with all taxpayers inheriting appreciated property.

The elimination of the well established tax relief arising from the step-up in basis of inherited property to value at death has been sought by the Treasury but refused by Congress. See Note, 65 Harv. L. Rev. 1024, 1031 fn. 54 (1952). No significant change on this point was made by the Internal Revenue Code of 1954. However, the coexistence of Sections 113(a)(5) and 126 (new Code Sections 1014 and 691, respectively) has been assured by a specific provision that new Section 1014 "shall not apply to property which constitutes a right to receive an item of income in respect of a decedent . . ." (Section 1014(c), 1954 Code). The reports of both the House and Senate Committees explain that Subsection 1014(c)

"makes explicit the rule of existing law". H.R.Rep. No. 1337, 83d Cong., 2d Sess. a267 (1954); Sen. Rep. No. 1622, 83d Cong., 2d Sess. 424 (1954). It is respectfully suggested that it is not within the province of the courts to make a change in the law which Congress expressly refused to make.

Illustrative of the fact that the Court of Appeals' interpretation of Section 126 is too broad is the history of the Regulations thereunder. In the initial regulations issued under Section 126 by T.D. 5233, 1943 Cum. Bull. 198, the Commissioner proposed to tax to a deceased partner's estate unrealized appreciation in partnership assets which were required to be sold to the surviving partners. The Commissioner soon abandoned this position by an amendment to the regulations by T.D. 5459, 1945 Cum. Bull. 193 and held that Section 126 applied only to the sale of assets consummated prior to the partner's death.

Prior cases construing Section 126 have been concerned largely with items of income *per se* as distinguished from income resulting from sales of goods or other assets. These cases differ from the instant case on the vital point—the income concerned had been earned or the goods sold before death.

O'Daniel's Estate v. Commissioner, 173 F. 2d 966 (2d Cir. 1949), thought by the court below to govern, is easily distinguished. The bonus was income *per se*—it was directly attributable to decedent's services. Equally important, every economic event giving rise to the bonus occurred prior to death. In sharp contrast, the income

producing events in the instant case occurred over a period of many months after death.

Even so, the decision in *O'Daniel's Estate* has been severely criticized. Flechner, "Tax Consequences of Payments to Widows", 29 *Taxes* 811 (1951). A further illustration of this distinction is the action of the Commissioner in *Dixon v. United States,* 96 F. Supp. 986 (E.D. Ky. 1950), *aff'd* without opinion, 192 F. 2d 82 (6th Cir. 1951). Dixon's estate sold certain accounts receivable which had their origin in the sale of magazines during Dixon's life. The receipts were held to be "income in respect of a decedent" and taxable in full to the estate pursuant to Section 126. In contrast, the estate also sold "inventory property" owned by decedent. The Commissioner originally included the receipts from the "inventory property" in the estate's income. By stipulation, however, the Commissioner conceded the difference in the two types of receipts and abandoned the tax imposed on the receipts from the "inventory property".

The conclusion that Section 126 was not intended to cover income from unrealized appreciation in value of property has been reached by other commentators. See Guterman, "New Problems Under Section 126 in Income and Estate Taxes", 24 *Taxes* 633 (1946); Scott, "A Critique of Section 126", 26 *Taxes* 127 (1948); Fink, "Recent Developments under Section 126", 7th *Inst. Fed. Tax.* 731 (N.Y.U. 1949); Drye, "The Taxation of a Decedent's Income", 8 *Tax L. Rev.* 201, 207 (1953), concludes:

> ". . . Thus, the interpretive pattern seems to have developed that where property is involved which

does not give rise to income until sale, there must be a sale, not merely a contract to sell, or no income arises under section 126 of the Code. This result follows even where the property is not capital in the hands of the decedent but an item of the character that would be fully taxable as ordinary income if realized upon by the decedent."

And in Handbook of Tax Techniques (1952), Guterman states at page 1125:

"• • • If Section 126 had not been an outgrowth of the statutory and judicial history outlined above, there might be room for the contention that that section was intended to prevent any item from escaping income tax, which might otherwise have been taxable to the decedent if he had been alive to receive it. No such broad interpretation of Section 126 is permissible in the light of this history."

A recent article by Krieg and Buschmann, "Section 126: 'Item of Gross Income in Respect of a Decedent'", 32 *Taxes* 651, 654 (1954), comments on the holding of the Court of Appeals in the *Linde* case as follows:

"The Ninth Circuit itself apparently abandoned the arguments of the parties and held that a right to income within the meaning of Section 126 is a right to collect sums of money without regard to the old test of realization. Without any comment the court held in the second issue that similar receipts were also subject to a tax on the amounts received in excess of basis. We think that the court is clearly wrong. • • •"

Thus this case involves an important question of federal tax law, as yet specifically unanswered by this Court. The decision of the Court of Appeals below, if allowed to stand, upsets well established general principles as to the realization of income, and would create uncertainty and confusion in the administration of the income tax laws affecting a large number of taxpayers. This is a continuing problem not solved by the 1954 Code. The decision is contrary to the opinion of many commentators, and the radical extension of the coverage of Section 126 is not supported by other court decisions. A proper and authoritative interpretation of the scope of Section 126 by this Court is urgently needed and respectfully requested.

IV

THE COURT OF APPEALS HAD NO AUTHORITY TO CONSIDER THE GROUNDS UPON WHICH IT REVERSED THE JUDGMENT OF THE TAX COURT.

In the Court of Appeals, both the Commissioner and the taxpayer directed their Section 126 arguments toward the significance of the decedent's transfer of grapes to the marketing association. The focal point on each side's case, and of the decision of the Tax Court (17 T.C. 593; Tr. 123) was the question whether this transfer was a "sale" on the one hand, a "trust" arrangement, a "consignment", or other non-taxable transaction.

But in complete contrast to this issue, the Court of Appeals reversed on the ground that a sale prior to death is immaterial, saying, at 213 F. 2d 7:

> "To say the expected proceeds would be income in respect to the decedent if the transaction was a sale, but not if it was a consignment, would be to apply an *irrelevant test.*" (emphasis supplied)

Such action *sua sponte* by the Court of Appeals plainly disregards what this Court has said it considers the "correct practice" for appeal courts. *Helvering v. Salvage,* 297 U.S. 106, 109 (1936). That is, where a ground or theory of a case has not been presented below by the parties, or considered by the trial or Tax Court, it should not be considered as ground for *reversal* by a reviewing court on appeal. *General Utilities & Operating Co. v. Helvering,* 296 U.S. 200 (1935); *Helvering v. Wood,* 309 U.S. 344 (1940); cf. *LeTulle v. Scofield,* 308 U.S. 415 (1940), where certiorari was granted because the petition alleged that the Circuit Court based its decision on a point not presented or argued by the litigants. And see the exhaustive discussion of this doctrine in *Rhodes v. Commissioner,* 111 F. 2d 53, 55-57 (4th Cir. 1940), where the Court concluded, at page 57:

> ". . . . inasmuch as this is an issue of law and fact which was not raised before the Board of Tax Appeals and is a contention made for the purpose of reversing the Board, *we hold that it cannot be considered by this Court.*" (Emphasis supplied)

Since the decision of the Court of Appeals in the instant case *reversed* the Tax Court on grounds not argued by the parties, petitioner submits that under the *General Utilities* doctrine, this Court should set aside the holding below and affirm the Tax Court.

Alternatively, since petitioner was prejudiced by the judgment which deprived her of the opportunity to answer the novel grounds relied upon, the case should be remanded for argument on this point. Cf. *Helvering v. Gowran*, 302 U.S. 238, 247 (1937).

CONCLUSION

This petition for a writ of certiorari should be granted.

Respectfully submitted,

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CLAUDE M. MAER, JR.,
Attorneys for Petitioner.

September, 1954.

APPENDIX A

Opinion of United States Court of Appeals for the Ninth Circuit, *Commissioner v. Linde*, 213 F. 2d 1.

Before Denman, Stephens and Pope, Circuit Judges.

Pope, Circuit Judge.

The respondent was the widow of Herman C. Lange who died December 10, 1943. The decedent was a farmer and owned and operated vineyards near Lodi, San Joaquin County, California. He marketed his wine grapes by delivering them to cooperative marketing associations of which he and other grape growers were members. The marketing associations processed their members' grapes into wine and other grape products and marketed the products on behalf of the members. The members of these associations delivered agreed quantities of grapes to the wineries of the associations where they were commingled with those of other members and each year they became a part of what was termed a wine pool for that year. Each member was assigned a percentage of interest in the pool. Ultimately the net proceeds from the sales of the products were returned to the members of the pools in proportion to their percentage of interest therein, all in accordance with the provisions of written agreements made between the association and the individual members.[1]

Respondent was the sole legatee under the will of Lange. The estate was closed in 1944. In that year decedent's share of certain liquidation proceeds of the asso-

[1]The facts relating to these agreements and the arrangements between the decedent and these associations are set forth at length in the opinion of the Tax Court, 17 T.C. 584 at 586 to 589.

ciations' pools were paid to the estate and in 1945 decedent's share of additional liquidation proceeds then payable were paid to the respondent taxpayer.

The principal question presented by the petition now before us is the contention that these payments received by respondent in 1945 in the amount of $38,484.12 constituted items of gross income in respect of a decedent taxable under section 126 of the Internal Revenue Code.[2] The Commissioner's determination to that effect was rejected by the Tax Court, Rose J. Linde, 17 T.C. 584. After examining the provisions of the marketing agreements between the decedent and the cooperative associations, that court concluded that notwithstanding the fact that these agreements referred to the members "selling" and the Associations "purchasing" the wine grapes, and notwithstanding other provisions indicating that the associations took title to the grapes and exercised rights of ownership over them, yet the parties never intended a sale of grapes to the associations to take place; that the relationship between the decedent and the associations which arose out of these agreements and the delivery of the grapes from which the proceeds here in question arose, was one of trust; and that the association was

[2]Sec. 126 (a) (1) provides as follows: "Income in Respect of Decedents. (a) Inclusion in Gross Income.—(1) General Rule.—The amount of all items of gross income in respect of a decedent which are not properly includible in respect of the taxable period in which falls the date of his death or a prior period shall be included in the gross income, for the taxable year when received, of: (A) the estate of the decedent, if the right to receive the amount is acquired by the decedent's estate from the decedent; (B) the person who, by reason of the death of the decedent, acquires the right to receive the amount, if the right to receive the amount is not acquired by the decedent's estate from the decedent; or (C) the person who acquires from the decedent the right to receive the amount by bequest, devise, or inheritance, if the amount is received after a distribution by the decedent's estate of such right."

a trustee or agent in respect to the grapes and the resultant proceeds and not a buyer pursuant to a sale.

In reaching this conclusion the Tax Court relied upon certain decisions dealing with the relationship between the members and such associations under California law.[5] The Tax Court pointed out that the payments received by the respondent in 1945 were the net proceeds of sales of products made by the associations in that year or in the latter part of 1944 after the date of decedent's death. It held: "Since such sales were not made during decedent's lifetime there could be no distributable proceeds due him when he died. Accordingly, no right to income from this source arose during the decedent's lifetime."

While the Commissioner does undertake to argue that under the marketing agreements here involved there was a sale of grapes to the associations, we find it unnecessary at this stage to reach that question; for it is our judgment that even assuming that sales were not made by decedent during his lifetime, yet the amounts paid to the respondent taxpayer in 1945 pursuant to and in accordance with the agreements with the associations constitute "income in respect of a decedent" within the meaning of section 126. We cannot agree with the Tax Court's conclusion that if such sales did not take place during the decedent's lifetime, section 126 has no application to the proceeds thus received by the taxpayer.

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[5]Olson v. Biola Coop. Raisin Growers Assn., 33 Cal. 2d 664, 204 P. 2d 10; Bogardus v. Santa Ana W. G. Assn., 41 Cal. App. 2d 939, 108 P. 2d 52. California & Hawaian Sugar Refining Corp. Ltd. v. Commissioner, 163 F. 2d 531, (9 cir.); San Joaquin Valley Producers Assn. v. Commissioner, (9 cir.), 136 F. 2d 382.

The decision of the Tax Court cannot be squared with that in O'Daniels Estate v. Commissioner, (2 cir.), 173 F. 2d 966. The decedent in that case had been an officer of a corporation which had a bonus plan in which the decedent had participated for a number of years. Decedent had no enforceable right under that plan to an allotment of a bonus for any year until the share was designated by the proper officer. Decedent died in 1943 and no share of the bonus for 1943 was designated until 1944, several months after his death, when the share was paid to his estate. It was held that such sum was gross income in respect of the decedent within the meaning of section 126(a)(1)(A). This was held notwithstanding decedent during his lifetime had no enforceable right to receive that amount. But attention was called to the fact that the payment represented compensation for services and that if decedent had lived to receive such amount it would have been includible in his gross income and reportable and taxable in that year as income for services. The court said: "The bonus was derived through rights he had acquired, which even if not fixed at the time of his death were then expectancies which later bore fruit." In our view the statement just quoted is equally applicable to the proceeds of the wine pools received by the respondent taxpayer in the year 1945. Cf. also Bausch's Estate v. Commissioner, (2 cir.), 186 F. 2d 313.

We think that the text of section 126 as well as the history of the legislation relating to the income of a decedent demonstrate the soundness of the O'Daniel decision and that the principles there expressed must be applied in the instant case. If the decedent had lived

until the day when these crop pool proceeds were paid to him the payments so received would have been ordinary income. Sec. 126 itself contains strong evidence of congressional intent to see to it that the tax upon income which would have been derived had the decedent lived should not be lost to the treasury in consequence of his death. Thus subparagraph 3 of section 126(a) provides that "The amount includible in gross income under paragraph (1) . . . shall be considered in the hands of the estate or such person to have the character which it would have had in the hands of the decedent if the decedent had lived and received such amount." The payments which the taxpayer received in 1945 were realized under and in consequence of contracts and deals made by the decedent in his lifetime. No act or thing taken or performed by the taxpayer operated to procure or to give rise to this payment. Such payments had their source exclusively in the decedent's contract and arrangement with the cooperative associations. And since in his hands had he lived and received these amounts they would have had the character of ordinary income, the quoted provision of subdivision 3 would make it appear that they have the same character, that is, ordinary income, in the hands of this taxpayer who acquired the right to receive that amount by bequest from the decedent within the meaning of subdivision (C) of subparagraph (1) of section 126(a). (See footnote 1, supra.)

The situation which led to a series of efforts on the part of Congress to avoid the loss of income taxes which would have been received were it not for the death of a

decedent, is stated in Helvering v. Enright, 312 U.S. 636, 639. There the court was dealing with the effect of section 42 of the Revenue Act of 1934. This is the section that provided that in the case of the death of a taxpayer there be included in computing net income for the taxable year in which his death fell amounts accrued up to the date of his death even although such amounts were not yet received and without regard to whether the decedent had reported income on a cash recipts and disbursements basis or otherwise.[1]

The court explained the reason for this 1934 enactment as follows: (p. 639) "The last sentence of Sec. 42 which requires the inclusion of 'amounts accrued up to the date of his death' in computing net income for the period in which his death falls was added by the 1934 Revenue Act. The reports recommended its addition because the 'courts have held that income accrued by a decedent on the cash basis prior to his death is not income to the estate, and under the present law, unless such income is taxable to the decedent, it escapes income tax

[1]There a lawyer on the cash basis was a member of a partnership whose partnership agreement provided that upon his death his estate would be entitled not only to his percentage in outstanding accounts, but also to a proportion of the estimated receipts from unfinished business. Upon his death the right in the uncollected accounts and to the accrued interest in the unfinished work were valued by agreement and the sums thus arrived at reported in the assets of estate and inheritance tax returns, but were not included in the income tax returns made for the decedent in the year of his death nor in the estate's income for that year or later years. It was held that the Commissioner accurately assessed these sums as a deficiency by including them in the decedent's return for the year of his death and that this amount was properly "accrued" within the meaning of Sec. 42, notwithstanding such sums would not have been accrued within the ordinary meaning of that term.

altogether.' "* The court undertook to effectuate this legislative objective of seeing to it that income which would have been taxable had the decedent lived to receive it should not escape income tax simply by reason of the decedent's death. It sustained the Commissioner's assessment of a deficiency which included an item of $40,855.77, representing the value of the interest of the deceased partner in the work of the partnership which was unfinished at the time of his death. In order to do so the court gave the word "accrued" a meaning beyond that generally used in referring to a taxpayer on the accrual basis. It said: "Accruals here are to be construed in furtherance of the intent of Congress to cover into income the assets of decedents, earned during their life and unreported as income, which on a cash return, would appear in the estate returns. Congress sought a fair reflection of income . . . The completion of the work in progress was necessary to fix the amount due but the right to payment for work ordinarily arises on partial performance. Accrued income under Sec. 42 for uncompleted operations includes the value of the services rendered by the decedent, capable of approximate valuation whether based on the agreed compensation or on quantum meruit." (p. 644) It is noteworthy that the rule applied in the Enright case would serve to bring about an additional tax in the case of the estate of a similarly situated decedent who had been reporting upon the accrual basis.

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*The court at this point added a footnote stating:

"This situation followed the decision of the Court of Claims in Nichols v. United States, 64 Ct. Cls. 241. A decedent on the cash basis was a member of a partnership dissolved by his death. Commissions earned before death but unpaid to the parnership were valued in the estate tax and collected by the partnership after death for payment to the executors. The Court of Claims held sums paid the executors were part of the corpus and not income."

In 1942 the new Sec. 126 was enacted. One reason for its enactment was that the device which Congress adopted in 1934 as exemplified in the Enright case resulted in a "bunching" of income which, had the decedent lived, would have extended over several years into the year of his death, and this was thought to result unfairly in the application of larger surtax rates. But while Sec. 126 was designed to relieve this bunching, there is nothing in the legislative history or in the text of Sec. 126 to indicate that it was intended to be anything other than an improved device to accomplish the general purpose of the internal revenue code that all income should pay a tax and that death should not rob the United States of the revenue which otherwise it would have had.[6] We think it clear that the intent of Congress continued to be as stated in the Enright case "to cover into income the assets of decedents earned during their life and unreported as income." As stated in the Committee reports, "The right to income is treated in the hands of the decedent differently from his other property, and when his estate or his legatee takes his place with respect to this income, it is proper to continue to treat this right in their hands in the same manner as it would be treated in the hands of the decedent." S. Rep. 1631, 77th Cong. 2d Sess. Cum. Bull. 1942-2, p. 580.[7]

Had the decedent lived to receive these sums in 1945 they would have been reportable and taxable in that year

[6]Of course the estate tax is no substitute for such an income tax loss. Sec. 126(c) provides that the recipient of income in respect of a decedent may deduct that portion of the estate tax levied on the decedent's estate which is attributable to the inclusion of the right to such income in the decedent's estate.

[7]An extensive quotation from this report appears as footnote (1) on page 968 of the O'Daniel case.

as income. Any right to receive those sums that was realized by the respondent taxpayer was acquired through Lange and never arose in any other way or through any other source.[5]

It has been suggested that the rule of Estate of Tom L. Burnett, 2 T. C. 897, supports the Tax Court's decision here. That case related to a contested adjustment for the year 1938, before section 126 was adopted. The court refused to extend the result reached in the Enright case to the fair market value on the date of the decedent's death of live stock and feed stuffs which had been raised by decedent up to the date of his death. The court said: "We have here simply the ownership of certain livestock and farm products which had been produced by the decedent on his ranches during his lifetime. This property had not been sold or exchanged by decedent at the time of his death. It was simply owned. No one was indebted to him for its fair market value or any part thereof. We do not think that the mere ownership of this property by decedent at the time of his death, even though it had been produced on his ranches during his lifetime, caused it to be gross income accrued to him up to the date of his death within the meaning of the language used in section 42 of the Revenue Act of 1938." The petition to review

[5]Such is the language used in the O'Daniel case in speaking of the bonus there received by decendent's estate: "It is true that the decedent would not have had a legally enforceable right to receive the foregoing amount until it was allocated by the American Cyanamid Company, but the payment clearly represented compensation for his services and any right to receive it that was realized by his estate was acquired through him and never arose in any other way or through any other source." 173 F. 2d 966, 967.

that decision was dismissed before hearing, and the Commissioner acquiesced in it.[9]

It is suggested that here the decedent's wine at the wineries was in no different situation than Brunett's feed stuffs in his barn. And the suggestion proceeds that the only purpose of section 126 was to relieve from the "bunching" effect of the 1934 Act, that it had no other objective, and hence that which would not be "amounts accrued up to the date of his death" under the 1934 Act, would not be "income in respect of a decedent" under section 126.

As we have previously indicated, it is our view that section 126 was but an improved method adopted by Congress in aid of its continuing effort to avoid the loss of tax upon income merely because of the death of the decedent who would have paid a tax upon the same economic returns had he lived to receive them.

The Internal Revenue Code as a whole manifests a general intent on the part of Congress to reach and tax all that rightly comes within the concept of income. Thus section 22(a) defines gross income in very broad terms, sweeping up into the general provision "gains or profits and income derived from any source whatever." The broad language there was an effective means to indicate the purpose to include all items that are constitutionally income.[10] The similarly broad and inclusive ref-

[9]In concluding its opinion the Tax Court noted that section 126 had then been adopted, and noting that it had no retroactive application to that case because of failure of the parties to file the requisite consents for that purpose, the court expressly confined its decision to the earlier provisions, without reference to section 126.

[10]United States v. Robertson, (10 cir.), 190 F. 2d 680, 682, (aff'd. 343 U.S. 711) and cases there cited. Cf. Roberts v. Commissioner, (9 cir.), 176 F. 2d 221, 225.

erence in section 126 to "all items of gross income in respect of a decedent which are not properly includible in respect of the taxable period in which falls the date of his death or a prior period" is, we think, the result of a conscious effort to catch and tax all items of the character here involved."

We are not called upon here to express any opinion upon the Tom L. Burnett decision. The Commissioner's acquiescence therein in no manner qualifies his right to insist that the amount here in controversy is subject to tax under section 126. In the Burnett case there was a question whether there had been a realization of income at the date of death. The improved mechanics of section 126 avoids any such problem, and any inconvenience and inequity arising from attaching a value to such farm proceeds prior to actual realization thereof, for under section 126 the tax is not imposed until the amount is received by the successor."

We find no merit in the suggestion that the gross income here referred to is limited to income from personal services. The language of section 126(a)(3), previously mentioned, discloses that it cannot be confined to any particular type or kind of income. For by that subsection "the amount includible in gross income under paragraph (1) or (2) shall be considered in the hands of the estate or such person to have *the character* which it would have had in the hands of the decedent if the decedent had lived *and received such* amounts." (Emphasis added) This clearly discloses that income from all

[11]The similar purpose of the 1934 enactment of section 42 was alluded to in Helvering v. McGlue's Estate, (4 cir.), 119 F. 2d 167.
[12]See note in 65 Harvard Law Review, 1024, at p. 1032.

sources was contemplated, including capital gains,[11] business income, interest, dividends, and the like; in short, income of the various types mentioned in section 29.22 (a)-1 of Regulations 111. For this reason the O'Daniel case cannot be distinguished from this one on the ground that it involved income from personal services. We perceive no difference between what O'Daniel's employer did in paying his estate the bonus, and what the cooperatives did in paying respondent taxpayer the proceeds of the wine pool. After decedent had delivered his grapes to the associations all he had remaining was a right to collect sums of money, the amounts of which awaited the event of marketing. To say the expected proceeds would be income in respect of the decedent if the transaction was a sale, but not if it was a consignment, would be to apply an irrelevant test.[12]

To make the decision turn on the label applied by the California courts to the relationship of decedent to the cooperatives is to disregard the fact that we have here a federal law designed to deal with broad concepts of income. In terms of realities there is no reason for distinguishing, tax-wise, between these particular contracts and others which the California courts might label other-

[11]Sen. Rep. No. 1631, 77th Cong. 2nd Sess. 1942-2, Cum. Bull. p. 580: "Since this section provides for the treatment of such amounts as income to the persons placed in the same position as the decedent with respect to such amounts, the provisions of section 113(a) (5) with respect to the basis of property do not apply to these amounts in their hands." In substantially the same words is Reg. 111, section 29.126-1. Thus the cost basis to the estate or legatee would be the decedent's cost basis, not the value on date of death.

[12]Frequently, to supply a practical solution as to who should have to stand a loss following fire or bankruptcy, courts make their decisions turn on whether, or when, a sale occurred. No similar compulsion requires such a line to be drawn here.

wise. Our problem is one of federal law." In just as real a sense these proceeds would have become income to the decedent had he lived to receive them, whether they be called sales or something else. We hold that these proceeds received in 1945 were income in respect of a decedent under section 126.

The remaining questions relate to the amounts received from the pools in 1944. The Tax Court, relying on our decision in Huesman's Estate v. Commissioner, 198 F. 2d 133, held that this was not income in respect of a decedent which could be taxed to the petitioner under section 162(c) of the Internal Revenue Code. (This holding is not challenged by petitioner.) But with respect to those amounts which were received by decedent's estate in 1944 from wine pools which remained unliquidated at decedent's death, and which were currently distributed to respondent in that year, it held that they were sums received by her from the sale of capital assets and that the excess over the basis fixed by section 113 for "property transmitted at death", was taxable as a capital gain.

The court arrived at this result by holding that what was termed in the Huesman case the "corpus" of the estate, and which respondent acquired by decedent's will, was an equitable interest in the grapes and grape products in the hands of the cooperatives. These, said the court, were capital assets. Their basis was their valuation for estate tax purposes, and the sales by the wineries produced a gain, which was so taxable.

"Lyeth v. Hoey, 305 U.S. 188, 193; Estate of Putnam v. Comm'r., 324 U.S. 393, 395.

Petitioner here, arguing from Osenbach v. Commissioner, (4 cir.), 198 F. 2d 235, and Hatch v. Commissioner, 14 T.C. 237, asserts that what decedent had, and left to respondent, was a mere contract right with respect to the proceeds of sales when made, and that respondent made her gain merely from the collection of the sums payable under that contract; that the gain was not from the sale or exchange of respondent's claim or contract right, and hence the gain was taxable as ordinary income under the rule of the Osenbach case, supra.

We think that the Tax Court's findings as to the character of these 1944 receipts, was not clearly erroneous, and we sustain its determination that these were capital gains. U. S. v. Cumberland Pub. Serv. Co., 338 U.S. 451, 456.

There is, however, one item of the 1944 collections upon which our opinion differs from that of the Tax Court. Among the sums received by the estate in 1944 was $14,047.19, decedent's share of the East-Side Winery's 1942 pool. The wine in this pool had been sold in 1943. The court held that when these proceeds were paid in 1944, it was "in the nature of payment of a claim held by the decedent against East-Side Winery and no part thereof was income of the estate in 1944." The court held: "Accordingly, we hold that no part of this payment was distributive income of petitioner in 1944."

We cannot approve this conclusion. Decedent made his returns on the cash basis. He did not receive this income prior to his death. It was not constructively received, for it could not "be drawn upon by him at any time" and its receipt was not "within his own control

and disposition."[10] The agreement with the winery provided that settlements with the grower "shall be made at such time or times as the Board of Directors may elect."[11]

We hold that the gains from this payment from East-Side Winery was distribution of income to respondent in 1944. And since it was not from the sale or exchange of the estate's or respondent's claim or chose in action, but resulted from the collection only, the gain is taxable as ordinary income. Osenbach v. Commissioner, supra.

The cause is remanded with directions to modify the judgment in accordance with this opinion.

(Endorsed:) Opinion. Filed May 4, 1954.

Paul P. O'Brien, Clerk.

JUDGMENT

Petition to Review a Decision of the Tax Court of the United States.

This cause came on to be heard on the Transcript of the Record from the Tax Court of the United States and was duly submitted.

On consideration whereof, it is now here ordered and adjudged by this Court, that this cause be, and hereby is remanded to the said Tax Court with directions to modify the decision in accordance with the opinion of this court.

(ENDORSED) Judgment

Filed and entered May 4, 1954,

PAUL P. O'BRIEN, Clerk.

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[10]The quoted phrases are from Regulations 111, 29.42-2.

[11]The Winery's auditor testified: "Q. When, with respect to the date of December 31, 1943, was that balance actually determined? A. That probably is very close to the transmittal letter which is April 29, 1944, and I would say 30 days prior to that date."

APPENDIX B

STATUTES AND REGULATIONS INVOLVED

INTERNAL REVENUE CODE (as in effect for the taxable years here involved).

Sec. 22. Gross Income.

(a) *General Definition.* — "Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service***, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.***

(b) *Exclusions from Gross Income.* — The following items shall not be included in gross income and shall be exempt from taxation under this chapter:

* * * * *

(3) [as amended by Sec. 111(a) of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Gifts, Bequests, Devises, and Inheritances.* — The value of property acquired by gift, bequest, devise or inheritance. There shall not be excluded from gross income under this paragraph, the income from such property, or, in case the gift, bequest, devise, or inheritance is of income from property, the amount of such income. For the purposes of this paragraph, if, under the terms of the gift, bequest, devise, or inheritance, payment, crediting, or distribution thereof

is to be made at intervals, to the extent that it is paid or credited or to be distributed out of income from property, it shall be considered a gift, bequest, devise, or inheritance of income from property;

• • • • •

(26 U.S.C. 1946 ed., Sec. 22.)

Sec. 111. Determination of Amount of, and Recognition of, Gain or Loss.

(a) *Computation of Gain or Loss.* — The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 113 (b) for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized.

• • • • •

(Sec. U.S.C. 1946 ed., Sec. 111.)

Sec. 113. Adjusted Basis for Determining Gain or Loss.

(a) *Basis (Unadjusted) of Property.* — The basis of property shall be the cost of such property; except that—

• • • • •

(5) [as amended by Sec. 144 of the Revenue Act of 1942, *supra*] *Property Transmitted at Death.* — If the property was acquired by bequest, devise, or inheritance, or by the decedent's estate from the decedent, the basis shall be the fair market value of such property at the time of such acquisition.*** In the case of an election made by the executor under section 811 (j), the time of acquisition of the property shall, for the purpose of this

paragraph, be the applicable valuation date of the property prescribed by such section in determining the value of the gross estate.

* * * * *

(b) *Adjusted Basis.* — The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided.

* * * * *

(26 U.S.C. 1946 ed., Sec. 113.)

Sec. 117. Capital Gains and Losses.

(a) *Definitions.* — As used in this chapter—

(1) [as amended by Sec. 151 (a) of the Revenue Act of 1942, *supra*] *Capital Assets.* — The term "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or property, used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23(l), or an obligation of the United States or any of its possessions, or of a State or Territory, or any political subdivision thereof, or of the District of Columbia, issued on or after March 1, 1941, on a discount basis and payable without interest at a fixed maturity date not exceeding one year from the date

of issue, or real property used in the trade or business of the taxpayer;

* * * * *

(b) [as amended by Sec. 150 (c) of the Revenue Act of 1942, *supra*] *Percentage Taken Into Account.* — In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net capital gain, net capital loss, and net income:

100 per centum if the capital asset has been held for not more than 6 months;

50 per centum if the capital asset has been held for more than 6 months.

* * * * *

(26 U.S.C. 1946 ed., Sec. 117.).

Sec. 126. [as added by Sec. 134 (e) of the Revenue Act of 1942, *supra*]. **Income in Respect of Decedents.**

(a) *Inclusion in Gross Income.*—

(1) *General Rule.* — The amount of all items of gross income in respect of a decedent which are not properly includible in respect of the taxable period in which falls the date of his death or a prior period shall be included in the gross income, for the taxable year when received, of:

(A) the estate of the decedent, if the right to receive the amount is acquired by the decedent's estate from the decedent;

(B) the person who, by reason of the death of the

decedent, acquires the right to receive the amount, if the right to receive the amount is not acquired by the decedent's estate from the decedent; or

(C) the person who acquires from the decedent the right to receive the amount by bequest, devise, or inheritance, if the amount is received after a distribution by the decedent's estate of such right.

* * * * *

(3) *Character of Income Determined by Reference to Decedent.* — The right, described in paragraph (1), to receive an amount shall be treated, in the hands of the estate of the decedent or any person who acquired such right by reason of the death of the decedent, or by bequest, devise, or inheritance from the decedent, as if it had been acquired by the estate or such person in the transaction by which the decedent acquired such right; and the amount includible in gross income under paragraph (1) or (2) shall be considered in the hands of the estate or such person to have the character which it would have had in the hands of the decedent if the decedent had lived and received such amount.

* * * * *

(c) *Deduction for Estate Tax.*—

(1) *Allowance of Deduction.* — A person who includes an amount in gross income under subsection (a) shall be allowed, for the same taxable year, as a deduction an amount which bears the same ratio to the estate tax attributable to the net value for estate tax purposes of all the items described in subsection (a) (1) as the value for estate tax purposes of the items of gross income

or portions thereof in respect of which such person included the amount in gross income (or the amount included in gross income, whichever is lower) bears to the value for estate tax purposes of all the items described in subsection (a) (1).

• • • • •

(26 U.S.C. 1946 ed., Sec. 126).

Sec. 1254. Courts of appeals; certiorari; appeal; certified questions.

Cases in the courts of appeals may be reviewed by the Supreme Court by the following methods:

(1) By writ of certiorari granted upon the petition of any party to any civil or criminal case, before or after rendition of judgment or decree;

• • • • •

(28 U.S.C. 1952 ed., Sec. 1254).

CALIFORNIA AGRICULTURAL CODE (DEERING, 1950)

Sec. 1208. Marketing contracts: Execution authorized: Passage of title to products: Provisions for sale of products, etc. The association and its members may make and execute marketing contracts, requiring the members to sell, for any period of time, not over fifteen years, all or any specified part of their products or specified commodities exclusively to or through the association, or any facilities to be created by the association. If they contract a sale to the association, it shall be conclusively held that title to the products passes absolutely and unreservedly, except for recorded liens, to the association upon delivery; or at any other specified time if expressly and definitely agreed in the said contract. The contract

may provide that the association may sell or resell the products delivered by its members, with or without taking title thereto; and pay over to its members, the resale price, after deducting all necessary selling, overhead and other costs and expenses, including interest on preferred stock, not exceeding eight per cent per annum, and reserves for retiring the stock, if any; and other proper reserves; and interest not exceeding eight per cent per annum upon common stock. [Enacted 1933.]

TREASURY REGULATIONS 111, promulgated under the Internal Revenue Code, Part 29 of Title 26, Code of Federal Regulations (1943 Supp.)

Sec. 29.22(a)-1. *What Included in Gross Income.*— Gross income includes in general compensation for personal and professional services, business income, profits from sales of and dealings in property, interest, rent, dividends, and gains, profits and income derived from any source whatever, unless exempt from tax by law. (See sections 22(b) and 116.) In general, income is the gain derived from capital, from labor, or from both combined, provided it be understood to include profit gained through a sale or conversion of capital assets.***

* * * * *

Sec. 29.22(a)-7. *Gross Income of Farmers.* — A farmer reporting on the basis of receipts and disbursements (in which no inventory to determine profits is used) shall include in his gross income for the taxable year (1) the amount of cash or the value of merchandise or other property received during the taxable year from the sale of live stock and produce which were raised dur-

ing the taxable year or prior years, (2) the profits from the sale of any live stock or other items which were purchased, and (3) gross income from all other sources.***

* * * * *

As herein used the term "farm" embraces the farm in the ordinarily accepted sense, and includes stock, dairy, poultry, fruit, and truck farms; also plantations, ranches, and all land used for farming operations. All individuals, partnerships, or corporations that cultivate, operate, or manage farms for gain or profit, either as owners or tenants, are designated as farmers.***

* * * * *

Sec. 29.22(b)(3)-1. *Gifts and Bequests.* — Property received as a gift, or received under a will or under statutes of descent and distribution is not includible in gross income, although the income from such property is includible in gross income. If the gift, bequest, devise, or inheritance is of income from property, it is not to be excluded from gross income.***

* * * * *

Sec. 29.113(a)(5)-1. *Basis of Property Acquired by Bequest, Devise, or Inheritance.*—***

(b) *Basis.* — Section 113(a)(5) provides three rules for determining the basis of property transmitted at death, first, a rule governing property generally, second, a special rule governing stock in a foreign personal holding company, and, third, a special rule applicable to both the first and second rules in certain cases where for estate tax purposes the decedent's gross estate is valued at the optional valuation dates.

(1) *General rule.* — Except as prescribed in paragraphs (2) and (3) of this subsection the basis of property acquired from a decedent by will or under the law governing the descent and distribution of the property of decedents is the fair market value at the time of such acquisition. Since, under the law governing wills and the distribution of the property of decedents, all titles to property acquired by bequest, devise, or inheritance relate back to the death of the decedent, even though the interest of him who takes the title was, at the date of death of the decedent, legal, equitable, vested, contingent, general, specific, residual, conditional, executory, or otherwise, the time of the acquisition of such property is the death of the decedent.***

The purpose of the Internal Revenue Code, in prescribing a general uniform basis rule for property acquired by bequest, devise, or inheritance, is, on the one hand, to tax the gain, in respect of such property, to him who realizes it (without regard to the circumstance that at the death of the decedent it may have been quite uncertain whether the taxpayer would take or gain anything); and, on the other hand, not to recognize as gain any element of value solely from the circumstance that the possession or enjoyment of the taxpayer was postponed. Such postponement may be, for example, until the administration of the decedent's estate is completed, until the period of the possession or enjoyment of another has terminated, or until an uncertain event has happened. It is the increase or decrease in the value of property reflected in a sale or other disposition which section 113(a)(5) recognizes as the measure of gain or loss.

* * * * *

Sec. 29.117-1. *Meaning of Terms.* — The term "capital assets" includes all classes of property not specifically excluded by section 117(a)(1). In determining whether property is a "capital asset," the period for which held is immaterial.

The exclusion from the term "capital assets" of property used in the trade or business of a taxpayer of a character which is subject to the allowance for depreciation provided in section 23 (l) and of real property used in the trade or business of a taxpayer is limited to such property used by the taxpayer in the trade or business at the time of the sale, exchange, or involuntary conversion. Gains and losses from the sale or exchange of such property are not subject to the percentage provisions of section 117(b) and losses from such transactions are not subject to the limitations on losses provided in section 117(d), except that under section 117(j) the gains and losses from the sale or exchange of such property held for more than six months may be treated as gains and losses from the sale or exchange of capital assets, and may thus be subject to such limitations. See section 29.117-7. Property held for the production of income, but not used in a trade or business of the taxpayer, is not excluded from the term "capital assets" even though depreciation may have been allowed with respect to such property under section 23(l) prior to its amendment by the Revenue Act of 1942. However, gain or loss upon the sale or exchange of land held by a taxpayer primarily for sale to customers in the ordinary course of his business, as in the case of a dealer in real estate, is not subject to the limitations of section 117(b),

(c), and (d). The term "ordinary net income" as used in these regulations for the purposes of section 117 means net income exclusive of gains and losses from the sale or exchange of capital assets.

* * * * *

Sec. 29.126-1 [As amended by T.D. 5389, July 10, 1944, T.D. 5458, June 15, 1945, and T.D. 5459, June 18, 1945]. *Inclusion in gross income of income in respect of a decedent.*—The gross income for the taxable year of a decedent beginning on or after January 1, 1943, in which falls the date of his death, is computed upon the basis of the method of accounting followed by such decedent, even though amounts to which he is entitled as gross income are not includible under such method in computing net income for such taxable year or any prior taxable year. See section 29.42-1. Such amounts include all the accrued income of a decedent who reported his income on the basis of cash receipts and disbursements, and in the case of a decedent who reported his income under the accrual method of accounting, such amounts include contingent items which were not accrued by the decedent and, under section 29.42-1, all items (except the amount of partnership income includible under section 182) which were accrued in the last taxable year of the decedent solely by reason of his death. For example, if the decedent who reported income on the basis of the accrual method of accounting was a member of a partnership which kept its books on the basis of cash receipts and disbursements, the decedent would be entitled at the date of his death to his distributive share of the accrued income of the partnership, although there would be in-

cluded in his gross income only his distributive share of the partnership income computed on the basis of cash receipts and disbursements.

* * * * *

Also placed in the same position as the decedent with respect to such amounts are those who acquire the right to such amounts by reason of the death of the decedent. An example of the application of this provision is the case of a decedent who owned a defense bond, with his wife as coowner or beneficiary, and who died before the payment of such bond. The entire amount accruing on the bond and not includible in income by the decedent, not just the amount accruing after the death of the decedent, would be treated as income to his wife when the bond is paid. Another example is the case of a partner whose partnership agreement provided that upon his death his interest in certain partnership assets would pass to the surviving partners in exchange for payments to be made by them to his widow. Upon his death, the payments by the surviving partners must be included in the widow's income to the extent they are attributable to the earnings of the partnership accrued only by reason of his death. The income reflected by the payments to the extent they are so attributable was not includible in the partner's income since it was not received by the partner (for the purposes of the cash receipts and disbursements method of accounting) and was accrued only by reason of his death (for the purposes of the accrual method of accounting). If the payments are to be made to the widow as trustee for minor children, and if the right to receive such payments is transferred to the children upon their majority, the children are within the pro-

visions of section 126(a)(1) as receiving the right to such payments by reason of the death of the decedent, and must include such payments when received in their income to the extent the payments are attributable to the earnings of the partnership accrued only by reason of the death.

Example. Suppose that A and the decedent B were equal partners in a business possessed of tangible assets having a present value considerably in excess of cost; suppose that certain current partnership business was well advanced toward completion prior to the death of B; and suppose that the partnership agreement provided that, upon the death of one of the partners, all partnership assets, including unfinished business, should pass to the surviving partner, and that the surviving partner should make certain payments to the estate of the decedent. To the extent that the payments by A to the estate of B are attributable to B's interest in the previously earned proportion of the unfinished partnership business transactions, their receipt by the estate of B will reflect the realization of income. With respect to such portion of the payments by A as is attributable to B's interest in the tangible assets of the partnership which had appreciated in value, no gain to the estate of B will be recognized. If some portion of the payments by A is attributable to a sale of B's interest in partnership assets consummated by B prior to his death, however, the gain to the estate of B reflected in such payments will be recognized regardless of the character of the asset sold, and regardless of whether or not payment was due on a day which must occur after B's death.

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In the Supreme Court of the United States

OCTOBER TERM, 1954

No. 335

ROSE J. LINDE, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. 104-131) are reported at 17 T. C. 584. The opinion of the Court of Appeals (Pet. 29-43) is reported at 213 F. 2d 1.

JURISDICTION

The judgment of the Court of Appeals was entered on May 4, 1954 (Pet. 43). A petition for rehearing was denied on June 7, 1954 (Pet. 2). The petition for a writ of certiorari was filed on

September 4, 1954. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254(1).

QUESTIONS PRESENTED

1. Whether the payments received by petitioner in 1945 in liquidation of wine pools of grower cooperatives in which she held bequeathed interests constitute "income in respect of a decedent" taxable to her under Section 126 of the Internal Revenue Code of 1939.

2. Whether, if such payments are not "income in respect of a decedent", the amounts by which they (when added to any 1944 proceeds) exceeded the fair market value of taxpayer's interests in the pools when she acquired them are taxable to her as ordinary income under Section 22(a) or as capital gain under Section 117 of the Internal Revenue Code of 1939.

3. Whether the amount by which the liquidation payments from the East-Side Winery's 1942 pool received by the estate in 1944 and distributed to taxpayer in that year exceeded the fair market value of taxpayer's interest in that pool when she acquired it is taxable to her as ordinary income under Section 22(a) or as capital gain under Section 117 of the Internal Revenue Code of 1939, or is not taxable to her at all.

STATUTE AND REGULATIONS INVOLVED

The pertinent provisions of the statute and regulations involved are set forth in the Appendix, *infra*, pp. 13-26.

STATEMENT

Petitioner's statement of the case (Pet. 5-15) is accurate and complete. However, for purposes of clarity, we submit the following summary:

Petitioner's husband, the decedent, was a farmer, and during his lifetime he delivered grapes to grower cooperative associations of which he was a member (R. 107, 114). The principal purpose of such associations was the processing of grapes into wine and other grape products and the marketing of these products on behalf of the members (R. 108).

Under the marketing agreements and related by-laws, the decedent surrendered control over the grapes to the associations and acquired in exchange the right to participate *pro rata* in the net proceeds of the sales of the wine products (R. 92-93, 108-113). The marketing agreements each contained language to the effect that the member sells and the association purchases wine grapes (R. 108, 111). The associations exercised all rights of ownership over the grapes delivered (R. 93).

In his income tax returns, the decedent took deductions (according to the cash receipts and disbursements basis of accounting) for all the costs paid by him to produce and handle the grapes delivered by him to the associations (R. 36, 107).

The decedent died on December 10, 1943, testate. He named his wife, the petitioner, as sole beneficiary and executrix of his estate. The estate was

closed in December, 1944 and in that month all the property of the estate was distributed to petitioner. (R. 107.)

At the time of his death the decedent had an interest in several wine pools, and after his death the associations concerned made payments from time to time in liquidation of the pools. The associations did not wait until all products were sold before making payments. As sales were made, the expenses were deducted, the net proceeds computed, and such net proceeds were currently distributed to the members. (R. 114-115.) Thus, certain payments were made to the estate in 1944 and other payments were made direct to the widow in 1945 (R. 115).

The Commissioner determined that payments made to the estate and currently distributed to petioner in 1944 and payments made directly to petitioner in 1945 constituted income in respect of a decedent taxable in full to petitioner under Section 126 of the Code (R. 117-118).

The Tax Court held that petitioner was not accountable for any of these payments under Section 126, and that she could only be taxed on a capital gains basis under Section 117 of the Code (R. 126-130). The Commissioner appealed from the portions of the Tax Court's decision decided adversely to the Government. Petitioner did not cross-appeal. (R. 133-143.)

The Court of Appeals for the Ninth Circuit affirmed as to the 1944 payments, with the exception

of a payment made from one pool, the wine in which had been sold in 1943. The Court of Appeals held that the gain from this payment was taxable to petitioner as ordinary income under Section 22(a) of the Code. (Pet. 41-43.)

The Court of Appeals reversed as to the 1945 payments. These payments, which had been made directly to petitioner, the court held taxable to her as income in respect of a decedent under Section 126. (Pet. 30-40.)

ARGUMENT

1. Petitioner contends that the proceeds of wine pools in which she held bequeathed interests paid directly to her in 1945 were erroneously held by the Court of Appeals to constitute "income in respect of a decedent" taxable to her under Section 126 of the Internal Revenue Code (App., *infra*, pp. 17-19), and in support of her petition asserts that the decision below conflicts with the decision of the Court of Appeals for the Fifth Circuit in *Campbell* v. *Prothro*, 209 F. 2d 331.

a. The payments clearly fall within the scope of Section 126. The were realized under and in consequence of contracts made by decedent in his lifetime. After decedent delivered the grapes to the associations, as the Court of Appeals observed, "all he had remaining was a right to collect sums of money" (Pet. 40). Decedent, when he delivered the grapes, lost control over them and had done all the acts and things necessary for him to do to create the income. Had he lived, there would have been

nothing more for him to do but to receive the money. Had he received the payments, they would have been taxed to him as ordinary income. The taxation of such income received after his death is the very kind of situation Section 126 was designed to cover. Since the amounts were collected directly by petitioner and not through the estate, they are taxable to petitioner and not to the estate. She stood in the shoes of decedent when she received the payments. 26 U.S.C., 1952 ed., § 126; Treasury Regulations 111, § 29.126-1, Appendix *infra,* pp. 21-26.

The payments are comparable to those in *Estate of O'Daniel* v. *Commissioner,* 10 T.C. 631, affirmed, 173 F.2d 966 (C.A. 2), where it was held that a bonus constituted income under Section 126. Decedent had performed the requisite services during his lifetime, but he had no legally enforceable right to receive the bonus at the time of his death. It was not until after he died that his share was designated by the proper officer of the company and paid to his estate. The court considered that the bonus was derived through rights that the decedent had acquired "which even if not fixed at the time of his death were then expectancies which later bore fruit." See 173 F.2d at 968. Similarly in *Helvering* v. *Enright,* 312 U.S. 636, which arose under Section 42 of the Revenue Act of 1934, c. 277, 48 Stat. 680,[1] this Court held that the share of a

[1] Section 42 of the Revenue Act of 1934 was enacted because the courts had held under prior law that income ac-

deceased member of a law firm in the estimated receipts from the unfinished business of the firm, valued as of the date of his death, should be included in computing his income for the period in which fell the date of his death.

The provision of the Revenue Act of 1934 which was involved in the *Enright* case resulted in hardship in some cases where amounts which would have been received over a number of years were returnable in the year of death, thus carrying the income into higher brackets. To alleviate this hardship, Section 126 of the Code was added (and Sections 42(a) and 43 were amended) by Section 134 of the Revenue Act of 1942 to provide that income accruing to a decedent because of his death was not includible in his final return but was to be treated as income and reported as income by the one receiving the right to such income. Such treatment was for the express purpose of alleviating a hardship and at the same time preventing income in respect of decedents from escaping taxation. H. Rep. No. 2333, 77th Cong., 2d Sess., pp. 83-88 (1942-2 Cum. Bull. 372, 435-439); S. Rep. No. 1631, 77th Cong., 2d Sess., pp. 100-105 (1942-2 Cum. Bull. 504, 579-583).

b. Petitioner contends (Pet. 15-18) that the decision below conflicts with *Campbell* v. *Prothro*,

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crued by a decedent on the cash basis prior to his death was not income to the estate but a part of the corpus. See *Helvering* v. *Enright*, 312 U.S. at 639. Hence prior to the Revenue Act of 1934 neither the estate nor the decedent paid income tax on such income.

209 F.2d 331 (C.A. 5), where it was held that a farmer who made a gift of raised calves to charity realized no income in making the gift. This contention lacks merit. The Commissioner does not contend that mere ownership by the decedent at the time of his death is enough to support taxation under Section 126. Cf. *Burnett* v. *Commissioner*, 2 T.C. 897 (Acquiescence, 1944 Cum. Bull. 4). Here the decedent had parted with control and the indicia of ownership by delivery of the grapes to the association, and he had thereby acquired the right to a *pro rata* share of the proceeds of the sale of the wine products. The income derived from completed business transactions which decedent had had with the associations. This is enough to support taxation under Section 126, which was designed to tax income in respect of decedents to the estate or legatee receiving it, even though not fully realized by the decedent during his lifetime.

Moreover, although the court below found it unnecessary to decide the point (Pet. 31),[2] we believe that under the marketing agreements here involved there was a "sale" of grapes by decedent to the

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[2] Contrary to petitioner's suggestion (Pet. 25-27), the Commissioner urged in the courts below that the question of whether a "sale" had occurred prior to decedents death was immaterial. See, e.g., Commissioner's Court of Appeals brief: ". . . we submit that the instant question should not be decided on the basis of whether the sales of the products were made before or after the decedent's death" (p. 26). "In such a situation [as presented by the facts here] the substance of the transaction between the association and its members, whatever the label . . . gives rise to a transaction which creates a taxable event" (p. 33). See further, *id.* at 15, 23-27, 33-34; Commissioner's Tax Court brief, p. 25.

associations at the time they were delivered to the associations. The marketing agreements each contained language that the association "buys" and the grower "sells" to the association annually certain quantities of grapes (Pet. 6-7, 9). Section 1208 of the California Agricultural Code, enacted in 1933 (Pet. 49-50), provides in substance that a cooperative association and its members may execute a marketing contract requiring the members to sell to or through the association, and, if they "contract a sale to the association, it shall be conclusively held that title passes absolutely and unreservedly" to the association on delivery of the product. It is not disputed that on delivering the grapes to the associations, petitioner released all his power of control over them, and once he had thus delivered the grapes he had nothing more to do except to receive the proceeds of the sale of the wine products (R. 92-93). The Tax Court found that the associations "took legal title to, and otherwise exercised the rights of ownership over, the grapes delivered" (R. 123). Accordingly we think that the transactions in the instant case were sales within the meaning of Section 1208. *Olson* v. *Biola Coop. Raisin Growers Ass'n,* 33 Cal. 2d 664, 204 P. 2d 10.

The decision of the Court of Appeals, holding the 1945 payments taxable to petitioner as "income in respect of a decedent" under Section 126,[3] is

[3] If certiorari should be granted, the further question would arise whether (if the 1945 payments did not constitute income in respect of a decedent taxable in full to petitioner under Section 126) the excess of the amounts received by taxpayer

sound on the facts and not in conflict with prior decisions of this Court or of other courts of appeals.

2. While the petition is wholly devoted to the question whether the 1945 payments were properly held to be taxable to petitioner under Section 126, petitioner under "Questions Presented" lists three additional questions, numbered 2-4, concerned with various aspects of the 1944 payments (Pet. 3-4). The petition does not explain petitioner's failure to deal with these further questions.

The case was presented to the Court of Appeals on the assumption that the 1944 payments which had been paid to the estate were not taxable to petitioner under Section 126. *Estate of Huesman* v. *Commissioner,* 16 T.C. 656, affirmed, 198 F. 2d 133 (C.A. 9). The Tax Court held that the amounts by which the payments exceeded the appraised value of decedent's interest in the pools as of the date of death were taxable to petitioner as capital gain except in the case of the payment from the East Side Winery's 1942 pool, discussed below, which it

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in 1945 (when added to any 1944 proceeds) over the federal estate tax valuation should be taxed to her as ordinary income under Section 22(a) or as capital gain under Section 117 of the 1939 Code. In the Court of Appeals, the Commissioner urged that, if the payments did not constitute Section 126 income, the excess over appraised value as of the date of death should be taxed as ordinary income inasmuch as petitioner merely collected the amounts due from the associations and there was accordingly no sale or exchange of a capital asset. *Osenbach* v. *Commissioner,* 198 F.2d 235, 237-238 (C.A. 4); *Hatch* v. *Commissioner,* 14 T.C. 237, 243, reversed in part on other grounds, 190 F.2d 254 (C.A. 2).

held not taxable at all. Petitioner took no appeal from the Tax Court's decision, which (except as to the payment from the East Side Winery's 1942 pool) was affirmed by the Court of Appeals as not clearly erroneous (Pet. 42-43). Accordingly, petitioner cannot attack it in this Court. Cf. *LeTulle* v. *Scofield,* 308 U.S. 415, 421-422. Questions 2 and 3 as stated in the petition (p. 3) are not therefore properly before this Court.

Petitioner's question 4 (Pet. 3-4) presents the question of the tax liability of petitioner on account of the payment received by the estate in 1944 and distributed to petitioner in that year from the East Side Winery's 1942 pool. The wine in this pool had been sold in 1943 (Pet. 42). As to this item, the Court of Appeals reversed the Tax Court and held the amount by which the payment exceeded the appraised value of decedent's interest in the pool taxable to petitioner as ordinary income. Since the Court of Appeals decided this question adversely to petitioner on the Commissioner's appeal from the Tax Court, petitioner may properly ask that the decision of the Court of Appeals as to this be reviewed by this Court. However, petitioner has presented no reasons in her petition why this question should be reviewed, perhaps because the gain on this payment subject to tax ($47.19) is insignificant (R. 115).

CONCLUSION

The decision below is correct and there is no conflict of decisions requiring review. The petition for a writ of certiorari should be denied.

Respectfully submitted,

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OCTOBER, 1954.

APPENDIX

Internal Revenue Code of 1939:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

(b) *Exclusions from Gross Income.*—The following items shall not be included in gross income and shall be exempt from taxation under this chapter:

* * * * *

(3) [as amended by Sec. 111(a) of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Gifts, Bequests, Devises, and Inheritances.*—The value of property acquired by gift, bequest, devise, or inheritance. There shall not be excluded from gross income under this paragraph, the income from such property, or, in case the gift, bequest, devise, or

inheritance is of income from property, the amount of such income. For the purposes of this paragraph, if, under the terms of the gift, bequest, devise, or inheritance, payment, crediting, or distribution thereof is to be made at intervals, to the extent that it is paid or credited or to be distributed out of income from property, it shall be considered a gift, bequest, devise, or inheritance of income from property;

* * * * *

(l) [as added by Sec. 134(c) of the Revenue Act of 1942, *supra*] *Income of Decedents.*—For inclusion in gross income of certain amounts which constituted gross income in respect of a decedent, see section 126.

(26 U.S.C. 1952 ed., Sec. 22.)

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property; except that—

* * * * *

(5) [as amended by Sec. 144 of the Revenue Act of 1942, *supra*] *Property Transmitted at Death.*—If the property was acquired by bequest, devise, or inheritance, or by the decedent's estate from the decedent, the basis shall be the fair market value of such prop-

erty at the time of such acquisition. * * * In the case of an election made by the executor under section 811(j), the time of acquisition of the property shall, for the purpose of this paragraph, be the applicable valuation date of the property prescribed by such section in determining the value of the gross estate.

* * * * *

(b) *Adjusted Basis.*—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided.

* * * * *

(26 U.S.C. 1952 ed., Sec. 113.)

SEC. 117. CAPITAL GAINS AND LOSSES.

(a) *Definitions.*—As used in this chapter—

(1) [as amended by Sec. 115(b) of the Revenue Act of 1941, c. 412, 55 Stat. 687, and Sec. 151(a) of the Revenue Act of 1942, *supra*] *Capital Assets.*—The term "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the

close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or property, used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23 (l), or an obligation of the United States or any of its possessions, or of a State or Territory, or any political subdivision thereof, or of the District of Columbia, issued on or after March 1, 1941, on a discount basis and payable without interest at a fixed maturity date not exceeding one year from the date of issue, or real property used in the trade or business of the taxpayer;

* * * * *

(b) [as amended by Sec. 150(c) of the Revenue Act of 1942, *supra*] *Percentage Taken Into Account.*—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net capital gain, net capital loss, and net income:

100 per centum if the capital asset has been held for not more than 6 months;

50 per centum if the capital asset has been held for more than 6 months.

* * * * *

(26 U.S.C. 1952 ed., Sec. 117.)

SEC. 126 [as added by Sec. 134(e) of the Revenue Act of 1942, *supra*]. INCOME IN RESPECT OF DECEDENTS.

(a) *Inclusion in Gross Income.*—

(1) *General Rule.*—The amount of all items of gross income in respect of a decedent which are not properly includible in respect of the taxable period in which falls the date of his death or a prior period shall be included in the gross income, for the taxable year when received, of:

(A) the estate of the decedent, if the right to receive the amount is acquired by decedent's estate from the decedent;

(B) the person who, by reason of the death of the decedent, acquires the right to receive the amount, if the right to receive the amount is not acquired by the decedent's estate from the decedent; or

(C) the person who acquires from the decedent the right to receive the amount by bequest, devise, or inheritance, if the amount is received after a distribution by the decedent's estate of such right.

* * * * *

(3) *Character of Income Determined by Reference to Decedent.*—The right, described in paragraph (1), to receive an amount shall be treated, in the hands of the

estate of the decedent or any person who acquired such right by reason of the death of the decedent, or by bequest, devise, or inheritance from the decedent, as if it had been acquired by the estate or such person in the transaction by which the decedent acquired such right; and the amount includible in gross income under paragraph (1) or (2) shall be considered in the hands of the estate or such person to have the character which it would have had in the hands of the decedent if the decedent had lived and received such amount.

* * * * *

(c) *Deduction for Estate Tax.*—

(1) *Allowance of Deduction.*—A person who includes an amount in gross income under subsection (a) shall be allowed, for the same taxable year, as a deduction an amount which bears the same ratio to the estate tax attributable to the net value for estate tax purposes of all the items described in subsection (a)(1) as the value for estate tax purposes of the items of gross income or portions thereof in respect of which such person included the amount in gross income (or the amount included in gross income, whichever is lower) bears to the value for

estate tax purposes of all the items described in subsection (a)(1).

* * * * *

(26 U.S.C. 1952 ed., Sec. 126.)

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939:

SEC. 29.22(a)-7. *Gross Income of Farmers.* —A farmer reporting on the basis of receipts and disbursements (in which no inventory to determine profits is used) shall include in his gross income for the taxable year (1) the amount of cash or the value of merchandise or other property received during the taxable year from the sale of live stock and produce which were raised during the taxable year or prior years, (2) the profits from the sale of any live stock or other items which were purchased, and (3) gross income from all other sources. * * *

* * * * *

As herein used the term "farm" embraces the farm in the ordinarily accepted sense, and includes stock, dairy, poultry, fruit, and truck farms; also plantations, ranches, and all land used for farming operations. All individuals, partnerships, or corporations that cultivate, operate, or manage farms for gain or profit,

either as owners or tenants, are designated as farmers. * * *

* * * * *

SEC. 29.113(a)(5)-1. BASIS OF PROPERTY ACQUIRED BY BEQUEST, DEVISE, OR INHERITANCE.— * * *

(b) *Basis.*—Section 113(a)(5) provides three rules for determining the basis of property transmitted at death, first, a rule governing property generally, second, a special rule governing stock in a foreign personal holding company, and, third, a special rule applicable to both the first and second rules in certain cases where for estate tax purposes the decedent's gross estate is valued at the optional valuation dates.

(1) *General rule.*—Except as prescribed in paragraphs (2) and (3) of this subsection the basis of property acquired from a decedent by will or under the law governing the descent and distribution of the property of decedents is the fair market value at the time of such acquisition. Since, under the law governing wills and the distribution of the property of decedents, all titles to property acquired by bequest, devise, or inheritance relate back to the death of the decedent, even though the interest of him who takes the title was, at the date of death of the decedent, legal, equitable,

vested, contingent, general, specific, residual, conditional, executory, or otherwise, the time of the acquisition of such property is the death of the decedent. * * *

The purpose of the Internal Revenue Code, in prescribing a general uniform basis rule for property acquired by bequest, devise, or inheritance, is, on the one hand, to tax the gain, in respect of such property, to him who realizes it (without regard to the circumstance that at the death of the decedent it may have been quite uncertain whether the taxpayer would take or gain anything); and, on the other hand, not to recognize as gain any element of value solely from the circumstance that the possession or enjoyment of the taxpayer was postponed. Such postponement may be, for example, until the administration of the decedent's estate is completed, until the period of the possession or enjoyment of another has terminated, or until an uncertain event has happened. It is the increase or decrease in the value of property reflected in a sale or other disposition which section 113(a)(5) recognizes as the measure of gain or loss.

* * * * *

SEC. 29.126-1 [as amended by T.D. 5459, 1945 Cum. Bull. 193]. *Inclusion in Gross Income of Income in Respect of a Decedent.*—The gross income for the taxable year of a decedent be-

ginning on or after January 1, 1943, in which falls the date of his death, is computed upon the basis of the method of accounting followed by such decedent, even though amounts to which he is entitled as gross income are not includible under such method in computing net income for such taxable year or any prior taxable year. See section 29.42-1. Such amounts include all the accrued income of a decedent who reported his income on the basis of cash receipts and disbursements, and, in the case of a decedent who reported his income under the accrual method of accounting, such amounts include contingent items which were not accrued by the decedent and, under section 29.42-1, all items (except the amount of partnership income includible under section 182) which were accrued in the last taxable year of the decedent solely by reason of his death. For example, if the decedent who reported income on the basis of the accrual method of accounting was a member of a partnership which kept its books on the basis of cash receipts and disbursements, the decedent would be entitled at the date of his death to his distributive share of the accrued income of the partnership, although there would be included in his gross income only his distributive share of the partnership income computed on the basis of cash receipts and disbursements.

Under section 126(a)(1), all such amounts

to which a decedent is entitled as gross income and which are not includible in computing his net income for his last taxable year or any prior taxable year shall be included, when received, in the gross income of the estate of the decedent or of the person receiving such amounts if such amounts are received in a taxable year ending after December 31, 1942, by the estate of the decedent or by a person entitled to such amounts by bequest, devise, or inheritance from the decedent or by reason of the death of the decedent. These amounts are included in the income of the estate and such persons when received by them, regardless of whether or not they report income on the basis of cash receipts and disbursements.

The persons who are placed with respect to such amounts in the same position as the decedent are the decedent's estate (which in the great majority of cases will be the one who receives such amounts) and, if the estate does not collect such amounts but distributes the right to receive such amounts to the heir, next of kin, legatee, or devisee who inherited or was bequeathed or devised such right, such heir, next of kin, legatee or devisee. Thus, if the decedent who kept his books on the basis of cash receipts and disbursements was entitled at the date of his death to a large salary payment to be made in equal annual installments over five years, and his estate after collecting

two installments distributed the right to the remaining installment payments to the residuary legatee of the estate, the estate must include in its gross income the two installments received by it, and the legatee must include in his gross income each of the three installments received by him.

Also placed in the same position as the decedent with respect to such amounts are those who acquire the right to such amounts by reason of the death of the decedent. * * *

* * * * *

Since section 126 provides for the treatment of such amounts as income to the estate and other persons placed in the same position as the decedent with respect to such amounts, the provisions of section 113(a)(5) with respect to the basis of property acquired by bequest, devise, or inheritance do not apply to these amounts in the hands of the estate and such persons. Furthermore, section 126 only applies to the amount of items of gross income in respect of a decedent, and items which are excluded from his gross income under section 22(b) or section 116 are not within the provisions of section 126.

* * * * *

The right to receive an amount of income in respect of a decedent shall be treated in the

hands of the estate or the person entitled to receive such amount by bequest, devise, or inheritance from the decedent or by reason of his death as if it had been acquired in the transaction by which the decedent acquired such right, and shall be considered as having the same character it would have had if the decedent had lived and received such amount. The estate or such person is placed in the same position with respect to the nature of this income as the position the decedent enjoyed. Thus, if the income would have been capital gain to the decedent, if he had lived and had received it, from the sale of property held for more than six months, the income when received, or its fair market value if transferred, shall be treated in the hands of the estate or of such person as gain from the sale of the property, held for more than six months, in the same manner as if such person had held the property for the period the decedent held it, and had made the sale. Similarly, if the income is interest on United States obligations owned by the decedent, such income shall be treated as interest on United States obligations in the hands of the person receiving it, for the purpose of determining the credit provided by section 25(a) (1) and (2), as if such person owned the obligations with respect to which such interest is paid. If the amount would have constituted earned income to the dece-

dent, as in the case of the accrued wages of a decedent who reported income on the basis of cash receipts and disbursements, such amount shall constitute earned income to the person including such amount in his gross income to the same extent as if he had engaged in place of the decedent in the transaction in which the amount was earned. Such earned income would be included with the other earned income of such person, in determining his earned income credit, and such aggregate would of course be subject to the limitations on such credit. The estate is not allowed any credit for such income which is treated as earned income in its hands, since there is no provision in Supplement E (sections 161 to 172, inclusive) allowing such a credit in the case of an estate.

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